

REPORT OF THE
OFFICE OF THE AUDITOR GENERAL

248
REVIEW OF THE DEPARTMENT OF HEALTH
FINANCIAL AND BUDGETING RECORDS
PERTAINING TO THE HEALTH CARE DEPOSIT FUND

JULY 1975

TO THE
JOINT LEGISLATIVE AUDIT COMMITTEE

MEMBERS

Assembly

Bob Wilson, Chairman
Eugene A. Chappie
Mike Cullen
John Francis Foran

Senate

Anthony C. Beilenson
Clare L. Berryhill
George Deukmejian
James R. Mills

ASSEMBLYMAN
CHAIRMAN
BOB WILSON
SEVENTY-SEVENTH DISTRICT
EUGENE A. CHAPPIE
THIRD DISTRICT
MIKE CULLEN
FIFTY-SEVENTH DISTRICT
JOHN FRANCIS FORAN
SIXTEENTH DISTRICT

Joint Legislative Audit Committee

GOVERNMENT CODE: SECTIONS 10500-10504

California Legislature

SENATORS
ANTHONY BEILENSEN
TWENTY-SECOND DISTRICT
CLARE BERRYHILL
THIRD DISTRICT
GEORGE DEUKMEJIAN
THIRTY-SEVENTH DISTRICT
JAMES R. MILLS
FORTIETH DISTRICT

BOB WILSON
CHAIRMAN
ROOM 4126, STATE CAPITOL
SACRAMENTO, CALIFORNIA 95814
(916) 445-6161

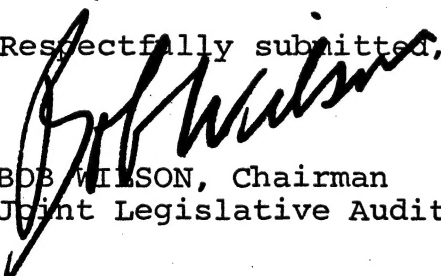
July 10, 1975

The Honorable Speaker of the Assembly
The Honorable President pro Tempore of
the Senate
The Honorable Members of the Senate and the
Assembly of the Legislature of California

Members of the Legislature:

I am today releasing the Auditor General's report on the
review of the Department of Health Financial and Budgeting
Records pertaining to the Health Care Deposit Fund.

Respectfully submitted,



BOB WILSON, Chairman
Joint Legislative Audit Committee



STATE OF CALIFORNIA

GLEN H. (JACK) MERRITT, C.P.A.
CHIEF DEPUTY AUDITOR GENERAL

925 L STREET, SUITE 750
SACRAMENTO, CALIFORNIA 95814
(916) 445-0255

Office of the
Auditor General

HARVEY M. ROSE, C.P.A.
AUDITOR GENERAL

JERRY L. BASSETT
ATTORNEY-AT-LAW
DEPUTY-CHIEF COUNSEL

PHILLIPS BAKER, C.P.A.
GERALD A. HAWES
JOHN H. McCONNELL, C.P.A.
DEPUTIES

June 4, 1975

Honorable Bob Wilson
Chairman, and Members of the
Joint Legislative Audit Committee
Room 4126, State Capitol
Sacramento, California 95814

Dear Mr. Chairman and Members:

Transmitted herewith is our report on a review of the
Department of Health financial and budgeting records,
pertaining to the Health Care Deposit Fund.

Respectfully submitted,

Harvey M. Rose
Auditor General

Staff: Glen H. Merritt
Jerry L. Bassett
Gerald A. Hawes
Phillips Baker
William H. Batt
Dan Turner
Charles A. Dobson
Wm. Gary Crews

TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION AND BACKGROUND	1
FINDINGS	
The accounting records of the Health Care Deposit Fund, maintained as presently required by statute, do not conform with the state General Fund and other governmental cost funds. As a result the General Fund unrestricted surplus at June 30, 1974 has been overstated by approximately \$134.8 million.	3
Recommendation	11
OTHER PERTINENT INFORMATION	13
WRITTEN RESPONSES TO THE AUDITOR GENERAL'S REPORT	
Director, Department of Finance	15
State Controller	17
Chief Deputy Director, Department of Health	20

INTRODUCTION AND BACKGROUND

In response to a legislative request, we have reviewed selected accounting and budgeting records of the Department of Health. Our review was limited to the operations of the Health Care Deposit Fund. During 1973-74, the Health Care Deposit Fund was only one of many funds being administered by the Department of Health Care Services (now the Department of Health), and was reviewed because its budget is over three times that of the next largest fund and has annual expenditures in excess of \$1.8 billion.

Chapter 4, Statutes of 1965, Second Extraordinary Session, created a medical assistance program (Medi-Cal) effective March 1, 1966, and created the Health Care Deposit Fund. The purpose of this program is to provide health care and related remedial or preventive services to recipients of public assistance and the medically needy.

The Medi-Cal program is designed to operate within the provisions of Title XIX of the Social Security Act in order to be on a 50-50 cost-sharing basis with the federal government for public assistance recipients.

There are three sources of funding for the program. They are the General Fund of the state, federal funds, and county funds. The funds from all sources are comingled in the Health Care Deposit Fund, which is maintained by the State Controller. The amount of state funds appropriated are transferred in such sums as are needed by the State Controller from the

General Fund to the Health Care Deposit Fund. The federal government reimburses the state quarterly for estimated costs incurred in that quarter. The Controller determines the amount payable by each county for its cost of care and administration of the Medi-Cal program at the beginning of each fiscal year based on the county's modified assessed value. The Department of Health then offsets monthly billings received from county hospitals against the county's share payable to the Health Care Deposit Fund and makes final adjustments at the end of each fiscal year.

FINDINGS

THE ACCOUNTING RECORDS OF THE HEALTH CARE DEPOSIT FUND, MAINTAINED AS PRESENTLY REQUIRED BY STATUTE, DO NOT CONFORM WITH THE STATE GENERAL FUND AND OTHER GOVERNMENTAL COST FUNDS. AS A RESULT THE GENERAL FUND UNRESTRICTED SURPLUS AT JUNE 30, 1974 HAS BEEN OVERSTATED BY APPROXIMATELY \$134.8 MILLION.

The accounting records of the Health Care Deposit Fund are kept on a cash basis of accounting, while the state General Fund and other governmental cost funds are kept on a modified accrual basis. General Fund monies are transferred into the Health Care Deposit Fund to pay for the state's share of the Medi-Cal program. As a result, the General Fund unrestricted surplus at June 30, 1974 was overstated by approximately \$134.8 million or 72 percent of the approximately \$187.2 million reported surplus.

The basic requirements of an accounting system are that:

- The accounts and reports be based on generally accepted accounting principles
- These principles must be consistently followed in successive periods.

Accounting for the Health Care Deposit Fund does not satisfy either one of these requirements. The cash method of accounting is not recognized as conforming to generally accepted accounting principles, and this method of maintaining the accounts has not been followed consistently in successive periods.

The Health Care Deposit Fund, like the General Fund, was kept on the accrual method of accounting (a matching of revenue and expenditures for the same period) from the inception of the Medi-Cal program in March 1966 until June 30, 1969. At that time, Section 14159 was added to the Welfare and Institutions Code to require the Health Care Deposit Fund to be kept on a modified accrual basis of accounting. The state General Fund was not placed on a modified accrual basis of accounting until July 1972. Section 14159 of the Welfare and Institutions Code, which became effective March 1969, stated:

"Expenditures for services and for state and county administration shall be charged against the appropriation for the fiscal year in which the billing is received."
(Emphasis added.)

Thus the modified accrual method of accounting does not match revenue and expenditures for a given period. Billings or charges for services provided during the accounting period and not received prior to June 30 are charged against the next year's appropriation.

This code section was amended, operative October 1971, to require that the fund be maintained on the cash basis of accounting for expenditures. Under the cash basis of accounting, revenues are recognized in the period received and costs are recognized in the period in which they are paid, rather than the period in which they are incurred. Section 14159 of the Welfare and Institutions Code now states:

"Expenditures for services and for state and county administration shall be charged against the appropriation for the fiscal year in which the billing is paid..."
(Emphasis added.)

At June 30, 1974, liabilities of the Health Care Deposit Fund were understated by approximately \$128.1 million and accounts receivable from counties were overstated by approximately \$6.7 million. Therefore, the Health Care Deposit Fund balance, and likewise the General Fund unrestricted surplus, was overstated by approximately \$134.8 million at June 30, 1974. This overstatement was composed of the following:

Unrecorded Liabilities and Overstated Accounts Receivable

Unpaid Medical Services	\$118,673,000
Amount Allegedly Due to the United States Department of Health, Education and Welfare (HEW)	<u>9,409,000</u>
Total Unrecorded Liabilities	\$128,082,000
Add: Overstatement of Accounts Receivable From Counties	<u>6,734,000</u>
Overstatement of Fund Balance at June 30, 1974	<u><u>\$134,816,000</u></u>

The items making up this overstatement are discussed separately below.

Unpaid Medical Services

Unpaid medical services of \$118,673,000 for services rendered during the 1973-74 fiscal year and unrecorded at June 30, 1974, were composed of \$110,633,000 which was the state's share of payments due to Medi-Cal providers, and \$8,040,000 which was the state's share of payments due to county hospitals. The state's share of county hospital billings was conservative since, due to a 60-day billing lag, the state had not received all of the county billings for May and June of 1974.

Amount Allegedly Due to HEW

Overpayments of approximately \$20.6 million were made to skilled nursing homes and extended care facilities for the period June 1, 1966 through June 30, 1969, of which only \$1.8 million has been recovered. Such overpayments were determined by Los Angeles Blue Cross audits and Oakland Blue Cross audits, fiscal intermediaries of the Department of Health Care Services (now the Department of Health).

From the inception of the Medi-Cal program in 1966 through July 1969, skilled nursing homes and extended care facilities were reimbursed on the basis of reasonable costs and it was during this period that the overpayments of \$20.6 million resulted. These costs were limited to certain maximum amounts and were subject to audit. In August 1969, these facilities had the option of being paid on the basis of reasonable costs or at a per diem rate for each Medi-Cal recipient in the facility. Effective January 1972, the problem of overpayments was resolved since these facilities were paid exclusively on the basis of established per diem rates which eliminated the need for audits to determine reasonable costs.

The audit and collection functions, of the skilled nursing homes and extended care facilities, were the responsibility of Blue Cross during the period of these overpayments. However, the Department of Health Care Services (now the Department of Health) had the responsibility to see that the audits and collections were performed. In January 1971, the Department of Health Care Services assumed the responsibility to perform the Medi-Cal audit function and the responsibility of collecting the overpayments.

Lack of timely effort on the part of Blue Cross and the Department of Health Care Services to collect these overpayments makes the prospect of future recoveries doubtful. According to the Department of Health, most of the nursing homes involved have terminated their participation in the Medi-Cal program and the department estimated that no more than ten percent of the \$18.8 million uncollected overpayments may be recoverable.

The Department of Health Care Services stated that overpayments were not recovered earlier for the following reasons:

- The department incorrectly assumed that Blue Cross was adequately making the collections
- Blue Cross was lax in making final settlements after the facilities were audited, and the amount of overpayments had not been determined for a substantial number of the facilities because cost reports had not been revised to give effect to the audit adjustments
- Overpayments were offset against future payments to the facilities. However, department policy was not to use the overpayment as an offset, if the facility appealed the audit adjustments, until after the appeal process was finalized.

In a letter dated January 23, 1973 to HEW, the U. S. General Accounting Office informed HEW of these overpayments. The letter states:

"In our opinion the Federal participation in the overpayment of \$18.8 million is questionable since the costs in question have been identified through audit as unallowable under the State plan. Accordingly, we would appreciate your views as to (1) the actions required by HEW to insure that as many as possible of these overpayments are collected and (2) the extent that the Federal Government should participate in the cost of those which are not recovered."

The state's share of the \$18.8 million overpayment is 50 percent or \$9.4 million, with the remaining 50 percent or \$9.4 million being the federal share.

The HEW position in July 1974 was that the federal government, which had already advanced the \$9.4 million, would take the entire \$9.4 million back, as has been done in the past. HEW's position was that audits had determined that these monies represent overpayments, and therefore these payments are considered as unallowable costs by HEW. HEW is presently attempting to collect the \$9.4 million from the state.

Overstatement of Accounts
Receivable From Counties

There is an an approximate 60-day lag in the processing of county hospital claims. The Department of Health's procedure is to offset these claims against the county's share payable to the Health Care Deposit Fund. This share is for the cost of care and administration of the Medi-Cal program

as provided in Section 14150 of the Welfare and Institutions Code. The offsets are made until the county's share due to the Health Care Deposit Fund has been fully paid. Due to the lag period, a portion of the 1973-74 claims payable to the counties was not recorded until July 1974, the first month of 1974-75. On the contrary, the receivables due from the counties were properly recorded. This resulted in the net overstatement of accounts receivable by \$6,734,000.

Effect on State General Fund

An annual report of the financial condition and transactions of the state is compiled from the records of the State Controller. The records are maintained during the year on a cash basis and are adjusted at the close of the fiscal year to reflect year-end accruals for all funds except the Health Care Deposit Fund. If the year-end accruals and the overstatement of accounts receivable of the Health Care Deposit Fund had been properly accounted for in preparing the Controller's Annual Report, the General Fund unrestricted surplus would have been shown as follows:

General Fund Unrestricted Surplus
June 30, 1974

General Fund Unrestricted Surplus As Reported in the Annual Report of the State Controller for Fiscal Year 1973-74	\$ 187,244,320
Less Overstated Receivables	(6,734,000)
Less Unrecorded Liabilities	<u>(128,082,000)</u>
Revised Unrestricted Surplus	<u>\$ 52,428,320</u>

The inconsistencies in accounting for the Health Care Deposit Fund, which started in July 1969, and which were compounded by the change to a cash basis of accounting in 1971, will continue in future years to distort the annual costs of the Medi-Cal program and the General Fund unrestricted surplus available for appropriation.

The General Fund unrestricted surplus projections at June 30, 1975 and June 30, 1976 by the Department of Finance, according to their May revision to the Governor's Budget, are \$392.2 million and \$135.1 million respectively.

The amount of unrecorded liabilities of the Health Care Deposit Fund at June 30, 1975 and June 30, 1976 cannot be determined at this time. It is reasonable to project, however, that they will be comparable to the unrecorded amount of June 30, 1974. Based on this projection, we estimate that the General Fund unrestricted surplus at June 30, 1975 will be \$264.1 million rather than the \$392.2 million shown in the May revision and at June 30, 1976 we estimate that this surplus will be \$7.0 million rather than the \$135.1 million surplus shown in the May revision. For purposes of conservatism, our estimates include no provision for overstated accounts receivable. The following is a recap of our estimates:

	<u>Millions</u>	
	<u>1975</u>	<u>1976</u>
General Fund Unrestricted Surplus at June 30 Per May Revision to Governor's Budget	\$392.2	\$135.1
Less: Unrecorded Liabilities of the Health Care Deposit Fund (Projected)	<u>128.1</u>	<u>128.1</u>
General Fund Surplus at June 30	<u>\$264.1</u>	<u>\$ 7.0</u>

CONCLUSION

The cash basis of accounting for expenditures of the Health Care Deposit Fund as required by Section 14159 of the Welfare and Institutions Code distorts the true financial position of the Health Care Deposit Fund as well as the state General Fund.

RECOMMENDATION

We recommend that the Legislature repeal Section 14159 of the Welfare and Institutions Code, and that the Department of Health maintain the accounting records of the Health Care Deposit Fund on the same modified accrual basis as the state General Fund and other governmental cost funds.

BENEFITS AND EFFECT OF RECOMMENDATION

Implementation of this recommendation would place the Health Care Deposit Fund on the same basis as other state funds, and reflect the true balance of the fund. The change in accounting method, to bring the Health Care Deposit Fund into conformance with the state General Fund, will require an additional General Fund appropriation, in the year of change, in the amount of the unrecorded liabilities of the Health Care Deposit Fund.

OTHER PERTINENT INFORMATION RELATING
TO THE HEALTH CARE DEPOSIT FUND

The budgets submitted in the past by the Department of Health to the Department of Finance have been unreliable and inadequate.

The Joint Legislative Budget Committee withheld recommendation on the Medi-Cal budget for fiscal year 1975-76 until they received more information on the budgeting process and current year projections. The Analysis of the Budget Bill states:

"We have reservations about the adequacy of the budget preparation process because the Medi-Cal Program estimates furnished us in past Governor's Budgets and May revisions have proven to be erratic and unreliable."

Information regarding the current budget and proposed budget estimates of average costs for each category of service and each category of recipient, and such information related to Medi-Cal utilization trends, could not be obtained by the Joint Legislative Budget Committee.

The Legislature added control language to the 1974-75 Budget Act requiring the Department of Health to submit to the Department of Finance quarterly reports with the assumptions and underlying supporting documents for all estimates relating to:

- The average monthly caseload for the medically needy and medically indigent

- The average cost for each category of service and each category of recipient
- Total estimated expenditures for each category of service
- Savings or costs associated with all regulatory or statutory changes.

These reports and all supporting data are also required to be submitted to the Joint Legislative Budget Committee on a timely basis.

Memorandum

Date : June 2, 1975

To : Mr. Harvey Rose
Auditor General

From : Department of Finance

Subject: Draft Report Entitled "Review of Department of Health Financial and Budgeting Records Pertaining to the Health Care Deposit Fund"

Thank you for the opportunity to comment upon your draft report concerning the Health Care Deposit Fund. I shall comment on the major recommendations in their order of appearance in the report:

1. Unpaid Medical Services

This, of course, deals with the entire matter of cash accounting versus modified accrual accounting. While there are respected sources who give legitimacy to cash accounting we must agree that, all other matters being equal, modified accrual accounting is the generally preferred method of state accounting and the basis upon which substantially all of the balance of state accounting is done.

Your report accurately emphasizes the basis for the major exception of the Health Care Deposit Fund from traditional State accounting practice, i.e., statutory law (Section 14159 of the Welfare and Institutions Code). While I agree in principle with your findings, I cannot at this time urge their implementation. The obvious impact upon revenue requirements is a policy matter which both the Legislature and the Administration must deal with in the event steps are taken to change the legal basis for accounting for the Health Care Deposit Fund.

2. Amount due HEW for reported nursing home overpayments

The Department of Health is currently negotiating with HEW to determine the amount of overpayment, if any, to be returned to the Federal Government via a reduction in the Federal Medi-Cal quarterly grant request. Until such time as the final amount is settled, I believe it is inadvisable to specifically reference any amount of possible state liability.

It has been our policy to budget and to account for Federal Audit exceptions only subsequent to resolution through acceptance, negotiation, or appeal.

Mr. Harvey Rose
Auditor General

* * * 1/

We stipulate to your general comments about the inadequacy of recent budget estimates. You are doubtless aware of major steps being undertaken to refine and upgrade the estimating process in the Department of Health. We are confident the most recent estimates contain a much higher degree of reliability. Only time, of course, will determine whether our confidence is well founded.

Thank you again for the early opportunity to review and comment on this report. I believe this new procedure for publishing Auditor General reports will redound to the benefit of all parties concerned.



ROY M. BELL
Director of Finance

cc: Mr. Mario Obledo
Secretary, Health & Welfare Agency

Dr. Jerome Lackner
Director
Department of Health

1/ Comments deleted refer to items shown in draft report but not included in this report.



KENNETH CORY

Controller of the State of California

SACRAMENTO, CALIFORNIA 95805

June 2, 1975

Harvey M. Rose
Auditor General
925 L Street - Room 750
Sacramento, California 95814

Attention: Glen H. Merritt, Chief Deputy Auditor General

Dear Mr. Rose:

You have asked for our comments on the recommendations and findings contained in a draft report on the operations of the Health Care Deposit Fund.

The findings are set forth on page 3 of the draft as follows:

"THE ACCOUNTING RECORDS OF THE HEALTH CARE DEPOSIT FUND, MAINTAINED * * * 1/ AS PRESENTLY REQUIRED BY STATUTE, DO NOT CONFORM WITH THE STATE GENERAL FUND AND OTHER GOVERNMENTAL COST FUNDS. AS A RESULT THE GENERAL FUND UNRESTRICTED SURPLUS AT JUNE 30, 1974 HAS BEEN OVERSTATED BY APPROXIMATELY [\$134.8] MILLION."

We agree that the basis of accounting is not the same for the Health Care Deposit Fund and the General Fund. The Health Care Deposit Fund expenditures are accounted on a cash basis and its receipts on the modified accrual basis. The General Fund revenues and expenditures are both accounted on a modified accrual basis. In both instances however, the method of accounting used complies with legal requirements. The comment that the General Fund unrestricted surplus at June 30, 1974 has been overstated by approximately [\$134.8] million, is not correct on the basis of statements prepared in compliance with legal requirements. The draft report findings are made on the basis of using modified accrual accounting for both funds. This treatment is in accordance with generally accepted accounting principles rather than legal requirements.

The National Committee on Governmental Accounting in its publication, Governmental Accounting, Auditing, and Financial Reporting, sets forth the basic principles which have been developed for and utilized by governmental units and are generally accepted as the official principles for governmental

1/ See comment 1/ on page 16.

accounting. On page 4 of the 1968 edition the following principle is set forth: "If there is a conflict between legal provisions and generally accepted accounting principles applicable to governmental units, legal provisions must take precedence. Insofar as possible, however, the governmental accounting system should make possible the full disclosure and fair presentation of financial position and operating results in accordance with generally accepted principles of accounting applicable to governmental units." The Committee recognizes that legal provisions differ from and conflict with sound accounting principles but, so long as they exist, they must be given precedence over the accounting principles or practices with which they differ.

The American Institute of Certified Public Accountants has published an Industry Audit Guide titled Audits of State and Local Governmental Units. The Institute takes the opposite view from the Committee. On page 12 of the Institute's publication the following statement is made: "In financial reporting, in the event of conflict between legal provisions and generally accepted accounting principles, the latter should take precedence." It then goes on to state that a supplemental statement should be prepared in accordance with the legal requirements if necessary. The Institute seems to contradict itself somewhat, since on page 90 of its publication the following comment is found: "Where opinions are expressed on the compliance of financial statements or supplemental schedules with legal requirements, e.g., the reporting of transactions on a cash basis under a revenue bond ordinance, the opinion should state whether or not they were prepared in conformity with applicable legal requirements. With respect to financial statements, the auditor's report should also state that the statements have not been prepared in conformity with generally accepted accounting principles, if such is the case."

Most textbooks on governmental accounting have adopted the principles set forth by the National Committee on Governmental Accounting. A recent publication titled Fund Accounting, authored by Edward S. Lynn and Robert J. Freeman published in 1974 states on page 29, "Governments must comply with the many and varied legal requirements, regulations, restrictions, and agreements that affect their financial management and accounting; and such compliance must be demonstrable and reported upon regularly. Compliance is necessary even though legal requirements may be archaic, useless, or even detrimental to sound financial management."

It appears, therefore, that your staff has adopted the philosophy set forth by the American Institute of Certified Public Accountants rather than that of the National Committee on Governmental Accounting.*

Page[11] of the report contains the conclusion that the cash basis of accounting for expenditures of the Health Care Deposit Fund as required by Section 14159 of the Welfare and Institutions Code distorts

* Auditor General comment: Our report is also in agreement with the principles of the National Committee on Governmental Accounting as quoted in the first paragraph above.

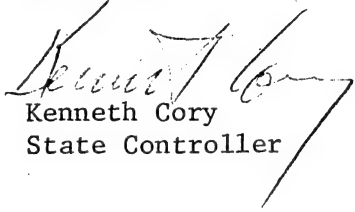
Harvey Rose, Auditor General
June 2, 1975
page 3

the true financial position of the Health Care Deposit Fund as well as the State General Fund. It is recommended that the Legislature repeal Section 14159 and the operations of the Health Care Deposit Fund be accounted on the modified accrual basis in the same manner as the records of the General Fund and other governmental cost funds are maintained.

At one time the fund was accounted on a modified accrual basis, but the financial statements prepared under that method were just as distorted as the draft report indicates they are distorted under the present method. It was found to be impossible to determine the actual liability because of the many services and goods supplied to participants which were not billed to the counties or the state until long afterwards. This was the basic reason for the legislation which put the expenditures on a cash basis rather than an accrual basis.

Thank you for this opportunity to comment on the findings and recommendations in the draft report.

Cordially,



Kenneth Cory
State Controller

KC/dm

Memorandum

To : Glen H. Merritt, CPA
Chief Deputy Auditor General
Office of Auditor General
925 L Street, Suite 750

Date : June 2, 1975

Subject: Review of the Department
of Health Financial and Budget-
ing Records Pertaining to the
Health Care Deposit Fund

From : Office of the Director

We appreciate the opportunity to review your draft audit report and to make comment pertaining to the audit findings of the Health Care Deposit Fund. Respecting your request, we have kept the contents of the report confidential.

In the response to several of the audit findings, the following comments are made to clarify or correct statements in the report:

Audit Finding, Page 3

"The accounting records of the Health Care Deposit Fund, maintained by the Department of Health as required by statute, do not conform with the State General Fund and other governmental cost funds."

Response

It is true that the accounts of the Health Care Deposit Fund are maintained on a different accounting method than used for the general fund or other governmental cost funds, but as the report indicates, the fund is being accounted for in accordance with present statute. The cash basis of accounting is still in use today in federal and other state jurisdictions, especially in situations where it is impractical to attempt to accrue expenditures due to the difficulties in accurately or reasonably determining the amount of payables at year-end.

Audit Finding, Page 3

Regarding the cash method of accounting for the Health Care Deposit Fund, the report states, "This method of maintaining the accounts has not been followed consistently in successive periods."

Response

Since implementing the cash basis during the 1971-72 Fiscal Year, in compliance with Section 14159 of the Welfare and Institutions Code, accounts of the HCDF have been maintained consistently in all subsequent accounting periods.

Audit Finding, Page 5

In the itemization of "Unrecorded Liabilities and Overstated Accounts Receivable", the report includes \$9.4 million under "Unpaid Medical Services" due to overpayments to skilled nursing facilities; ... and \$6.7 million, Overstatement of Accounts Receivable from Counties.

Response

The \$9.4 million stated overpayment to nursing facilities is in error and should be \$2.7 million. * * * ^{1/} one-half of the \$6.7 million or approximately \$3.3 million of Overstatement of Accounts Receivable from Counties, [was] also incorrectly included and should be deleted from the total [\$134.8] million shown as "Overstatement of Fund Balance at June 30, 1974". These items are discussed separately in more detail under Audit Findings on pages 6, 8, and 9.

Audit Finding, Page 6

Overpayments of approximately \$20.6 million were made to skilled nursing homes and extended care facilities for the period June 1, 1966 through June 30, 1969 of which only \$1.8 million has been recovered.

Response

A detailed analysis of the purported \$20.6 million overpayment to skilled nursing homes reveals a revised recoverable amount of \$5.5 million (\$2.7 million General Fund). The remaining \$15.1 million has been adjudicated in favor of nursing homes through the fair hearing process.

This \$20 million adjustment is illustrative of the problem which would be created if all expenditures were accrued by the Health Care Deposit Fund. Such an accrual would have overstated the General Fund surplus in prior years by more than \$5.0 million necessitating a current year General Fund deficiency appropriation.

* * * ^{1/}

^{1/} See comment ^{1/} on page 16.

* * * 1/Audit Finding, Page 9

Concerning the accounts receivable from counties, the audit report indicates that due to a lag in processing county hospital claims, which the Department offsets against the counties' share payable to the HCDF, the accounts receivable from the counties were overstated by \$6,734,000.

Response

The accounts receivable from the counties in the Health Care Deposit Fund at June 30, 1974 was not overstated by \$6,734,000. The audit report amount represents the gross amount of claims from county hospitals that were submitted in July 1974 and were used to reduce accounts receivable. Based on the premise that if the law was changed to accrue expenditures, only half of the \$6,734,000 would be picked up as accounts payable, since 50 percent of this amount represents the federal share. Therefore, \$3,367,000 would have had an effect on the General Fund unrestricted surplus on an accrual basis.*

Audit Finding, Page 13

"The Budgets submitted in the past by the Department of Health to the Department of Finance have been unreliable and inadequate."

"The Legislature added control language to the 1974-75 Budget Act requiring the Department of Health to submit to the Department of Finance quarterly reports with the assumptions and underlying supporting documents for all estimates...."

Response

Although the Medi-Cal budget estimates have been somewhat erratic in the past for a variety of reasons, a new estimating procedure has been developed for the current estimates which should alleviate some of these difficulties. This new Budget Information System (BIS), which provides the data for these estimates, supplies much more detail than was available in the past, and will permit monthly monitoring of the budget estimate. Using the new system, the Department of Health anticipates no problem in meeting the control language specified in the 1974-75 and 1975-76 Budget Acts. This new procedure has been approved by the Department of Finance and the Legislative Analyst's Office has been apprised of its advantages.

1/ See comment 1/ on page 16.

* Auditor General's comment: None of this amount is federally funded. Therefore, the entire \$6,734,000 is overstated.

June 2, 1975

Recommendation, Page [11]

"We recommend that the Legislature repeal Section 14159 of the Welfare and Institutions Code, and that the Department of Health maintain the accounting records of the Health Care Deposit Fund on the same modified accrual basis as the State's General Fund and other governmental cost fund."

Response

The above recommendation specifies the accounting basis to be used for the HCDF; however, the method to be used in determining the amount of payables to accrue at year-end is not indicated. We feel that the report should also include a definite recommendation as to an acceptable method to recognize payables for financial reporting purposes.

It would be extremely inappropriate to accrue all estimated expenditures of the Health Care Deposit Fund because the other two partners in the Fund (the Federal Government and counties) are on a cash basis. In addition, final hospital and nursing home expenditures are not known until final cost reports are received, audited, and in many cases adjudicated through the appeals process. This sequence takes from two to five years in many cases. In the interim, recordation of amounts due would have increased the General Fund surplus even though we would not have been able to collect the funds for at least two years. Establishment of accounts receivable resulting from possible overpayments to hospitals and/or nursing homes would lead the Federal Government to reduce their participation in the Medi-Cal program by 50 percent of such accounts receivable. Subsequent determination that the receivables were not collectable, as in the case of nursing homes, would result in a net loss to the General Fund equaling the federal share of such erroneous receivables.

In summary, we hope our comments will prove useful in the finalization in your audit report, and once again we thank you for the opportunity to make a response prior to the submission of this report to the Legislature. If you have any further questions, please do not hesitate to contact me.


R. T. Soderberg
Chief Deputy Director